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# **COMPLEMENTARITY BETWEEN REGIONAL AND GLOBAL FINANCIAL GOVERNANCE INSTITUTIONS: THE CASE OF ASEAN+3 AND THE GLOBAL FINANCIAL SAFETY NET**

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# **Complementarity between Regional and Global Financial Governance Institutions: The Case of ASEAN+3 and the Global Financial Safety Net<sup>1</sup>**

## **Abstract**

Three decades of financial crises culminating in the Global Financial Crisis have prompted the development of multi-layered global financial governance. In this article, we examine the relationship between the global and regional layers by analysing the case of the global and ASEAN+3 financial safety nets. Making use of regime theory, we examine the evolution of the characteristics, main institutions, goals and behavioural expectations of these two nets. In this article we argue that the ASEAN+3 regional financial safety net, which was mostly developed following the East Asian Financial Crisis of 1997, complements rather than undermines the global financial safety net. Similar characteristics, goals and behavioural expectations underpin this complementarity.

## **1. Introduction**

The Global Financial Crisis (GFC) and previous crises in East Asia, several Latin American countries or Russia, among others, underline the importance of developing solid, multilateral financial safety nets to pre-empt recurrence in the future.<sup>2</sup> Nonetheless, there is no agreement regarding the optimal geographical scope of these safety nets. Options include a global financial safety net (GFSN), a multitude of regional financial safety nets (RFSN), domestic safety nets or a combination of them. This is a relevant issue insofar contemporary financial flows have become globalised, yet the failure of the GFSN to prevent or swiftly solve the GFC and previous crises raises doubts regarding the effectiveness or even adequacy of a single GFSN.

The case of the ASEAN+3 RFSN is particularly useful to explore the relationship between regional and global safety nets. Prior to the GFC, the East Asian Financial Crisis (EAFC) of 1997 was regarded as the most damaging in decades in terms of its impact both on the economy of the affected countries and beyond them. As a result of the EAFC, several countries in the region started to develop financial safety nets to

prevent and manage future crises. These countries grouped themselves under a RFSN: ASEAN+3. Following the GFC, existing institutions have been upgraded and new ones have been launched.

An ASEAN+3-specific related net, however, did not emerge in a vacuum. Global and pan-Asian institutions are also in place. Indeed, the International Monetary Fund (IMF) and the Basel Committee on Banking Supervision (BCBS) were already involved in financial governance well before the EAFC. At the pan-Asian level, the Executives' Meeting of East Asia Pacific Central Banks (EMEAP) had been running for a few years when the EAFC struck. Several East Asian countries – most notably Japan – were already members of these institutions. This suggests recognition by government officials that an effective financial safety net, to the extent that it can be achieved, requires multilateral cooperation at the global level.

Furthermore, the EAFC compelled countries in the region to develop domestic safety nets. These were divided into two forms of self-insurance: central bank reserves and bilateral arrangements – mainly central bank currency swap agreements. Thus, China, Japan, Taiwan, South Korea, Hong Kong, Singapore and Thailand, in this order, are among the top 15 countries by foreign-exchange reserves as of 2014. Meanwhile, central banks in the region – led by the People's Bank of China – have signed a plethora of currency swap agreements. Even though domestic safety nets, by definition, are designed to only enhance the stability of the country developing them, their simultaneous adoption by most countries in a particular region supports RFSNs. Space constraints, however, prevents us from exploring the interaction between domestic safety nets on the one hand and RFSNs and the GFSN on the other.

The RFSN centred around ASEAN+3 is therefore part of a wider institutional framework with global, regional, and domestic layers. In common with the extant regional net in the Eurozone, the ASEAN+3 institutional framework belongs to a network of arrangements linked to each other. This safety net is especially interesting insofar ASEAN+3 lacks the legal and political framework which underpins financial governance in the EU. Concurrently, ASEAN+3 is arguably more integrated in other safety layers than the Eurozone. This is especially the case with regards to domestic arrangements.

The sophistication of the ASEAN+3 RFSN raises one important question: how does the ASEAN+3 financial safety net interact with the GFSN? The global framework centred around the BCBS and the IMF, regional institutions, and domestic arrangements simultaneously boost and potentially undermine the ASEAN+3 safety net. The relationship between all of them serves to determine the role of a well-developed regional layer in the GFSN.

In this article, we prove that RFSNs complement rather than replace the GFSN. Building on regime theory literature, we will analyse how the shortcomings of the GFSN explain the creation of RFSNs, leading to certain institutional characteristics that underpin their complementarity with the GFSN itself. A detailed case study of East Asia's RFSN – ASEAN+3 – will be used to guide our investigation of the extent to which they complement the GFSN.

The article will be organised as follows. Firstly, we will explain the main aspects of a regime theory approach. Afterwards, we will analyse the GFSN by looking at its different layers, characteristics and main goals. Subsequently, we will analyse the ASEAN+3 regional layer in detail, focusing on its evolution and how it explains its complementarity with the GFSN. Finally, a concluding section will summarise our argument.

## **2. Regime Theory**

Several scholars have advanced different definitions of regime. The most oft-used is Krasner's, who considers regimes as "principles, norms, rules and decision-making procedures around which actor expectations converge in a given issue-area."<sup>3</sup> This definition is similar to that advanced by Keohane and Nye, who describe regimes as "sets of governing arrangements affecting relationships of interdependence" that "may be affected by networks of rules, norms, and procedures that regularise behaviour and control its effects."<sup>4</sup> Krasner's definition is also similar to Young's, who talks about "specialised arrangements that pertain to well-defined activities, resources, or geographical areas."<sup>5</sup>

These definitions point out at three characteristics of international regimes. Firstly, regimes are created around a particular issue or area. This might be narrowly or broadly defined, but it has to be clear to participants in the regime. Otherwise, the regime will be ineffective insofar participating actors will be unable to ascertain the object of the regime. Secondly, regimes have goals. These relate to the particular issue or area around which a regime is built, and give a purpose to the regime itself. Thus, participants in the regime understand what they should strive to achieve. Finally, regimes create expectations of behaviour. In order to attain the goals of a particular regime, participants have to act according to certain patterns of codified and non-codified conduct. This way, participants in a regime can predict the actions of their peers.

Why are regimes constructed? Drawing from functionalist approaches to international regimes, Keohane argues that regimes are created when the anticipated (positive) effects of a regime outweigh the benefits of not having the regime.<sup>6</sup> States will hold the belief that regimes are superior to ad-hoc agreements if three conditions are met: legal liability, which refers to the organisation of relationships in mutually beneficial ways; a rearrangement of transaction costs, making non-compliance with the regime more costly than compliance; and a reduction in uncertainty as a result of the provision of reliable information.<sup>7</sup>

Haggard and Simmons indicate that regime theories based on functionalism do not particularly excel at explaining causality.<sup>8</sup> Nevertheless, Keohane's analysis of the conditions under which regimes are constructed carries explanatory power. The three conditions listed by Keohane double as the effects of well-functioning regimes. They amount to reciprocity, which is the cornerstone of international regimes and the main reason behind cooperation.<sup>9</sup>

As Axelrod explains, stable reciprocity among very few actors is sufficient for cooperation to begin. Cooperation can then expand to other issues and include more actors. Similarly, international regimes can be constructed by very few states seeking the effects of legal liability, transaction costs rearrangement, and reliable information provision. If these effects are achieved, regimes endure in time and might even expand to cover new issues and accommodate more states.<sup>10</sup>

It should be noted, however, that regimes are not static. They evolve over time, in at least four ways: strength, organisational form, scope, and allocation mode. Strength refers to the degree of compliance with the regime; organisational form makes reference to its design and operation, whether institutionalised or not; scope alludes to the range of issues covered by a regime; and allocation mode refers to the different social mechanisms to allocate resources.<sup>11</sup>

Change in an international regime can occur for different reasons, according to the theoretical approach that one takes. Following from the functionalism underpinning our approach to regimes, it would be argued that evolution or complete change take place when a regime becomes dysfunctional.<sup>12</sup> Drawing an analogy with domestic politics, regimes evolve when they do not perform properly, leading to the creation of new regimes that at least have the potential to work well.<sup>13</sup> Inability to solve a crisis, a realignment of interests or the presence of a free rider are some of the reasons which can make a regime dysfunctional. When this happens, regimes tend to metamorphose rather than disappear.

Adopting a functionalist approach to international regimes is not without its challenges. As Strange has argued, a significant risk associated to this approach stems from its state-centredness, which results on a focus on the positive aspects of regimes.<sup>14</sup> Meanwhile, Onuf has pointed out that the construction of regimes is a goal in and by itself. He believes that this is often neglected in the study of international regimes.<sup>15</sup> More fundamentally, Kratochwil and Ruggie have argued that this approach to the study of international regimes too easily assumes that goals can be distinguished from means. However, this distinction is not always clear.<sup>16</sup> These challenges could potentially render a functionalist study of international regimes obsolete.

Notwithstanding these challenges, a functionalist approach to international regimes retains its explanatory power. This approach calls our attention to the potential for regimes to enhance cooperation among states. Cooperation will result from the benefits of a regime outweighing the benefits of its non-existence. Keohane lays out the three main conditions why regimes appeal to states, as described above. Thus, a

functionalist approach serves to understand the benefits that states seek to obtain from a regime, along with the concomitant behavioural expectations that should ensure achievement of those benefits – regardless of these benefits being actually achieved. In short, a functionalist approach to regime theory serves to explain the emergence and evolution of a regime in terms of a convergence in interests that leads to goals and behavioural expectations to be articulated in a particular way. Recent examples of a functionalist approach to international regimes underpinning explanations of this convergence include scholarship on climate change,<sup>17</sup> economic governance,<sup>18</sup> environmental governance,<sup>19</sup> and inter-state peace.<sup>20</sup>

In the following section, we will examine the GFSN from the perspective of an evolving regime. The GFSN has suffered significant changes since its inception in the aftermath of World War II. Even though the overarching goal – financial safety – has remained constant, the meaning of this goal itself and behavioural expectations have changed overtime. A regime theory approach allows us to explain this evolution through the prism of changes in the form and characteristics of the GFSN.

### **3. Evolution of the Global Financial Safety Net as a Regime**

The modern GFSN regime is characterised by its multi-layered, institutionalised, and bureaucratised nature. The first characteristic refers to the division of the regime into interlinked global, regional, and domestic safety nets. Institutionalisation makes reference to the existence of a number of institutions involved in the development and management of the regime; these include the Bank for International Settlements (BIS), the BCBS or the Financial Stability Board (FSB), among others. Finally, the GFSN is bureaucratised insofar financial institution and government bureaucrats with expert knowledge are key drivers behind the design, implementation and monitoring of the regime. This does not neglect the existence of a process of bargaining among national politicians in the GFSN – which we will touch upon in this article even though it is not our focus; instead, it highlights the discretion and leverage that bureaucrats with the necessary technical expertise have once general goals have been agreed. How and why did the GFSN morphed into its present form?



The modern financial safety regime first started to develop with the launch of the IMF in 1944. Until the 1970s, the GFSN would be relatively simple. Essentially, it was made up of a global layer only, with the IMF as the main institution involved in the regime. The principal goal of the GFSN was crisis management, while the behavioural expectation was the acceptance by stressed sovereigns of liquidity provided by the IMF. This explains the central role of this institution in the regime. Almost since its inception, one of the functions of the IMF was the provision of liquidity to states experiencing balance of payments difficulties.<sup>21</sup> This was essential to maintain the Bretton Woods system in place from 1944 onwards.

In the 1960s, the BIS provided limited support to states whose currencies were suffering exchange rate convertibility problems, such as France and the UK.<sup>22</sup> Nevertheless, financial repression until the 1970s in the form of limitations to cross-border investment flows greatly reduced the number of financial crises. Most notably, banking crises were almost non-existent from the 1950s to the 1970s.<sup>23</sup> Most states had restrictions on transnational flows, leading to stable financial markets. As a result, the role of the BIS in the GFSN was limited compared to the IMF's.

### *Financial liberalisation and the need for crisis prevention*

The end of the Bretton Woods System in 1971 and the progressive liberalisation of capital accounts across the world led to the development of a substantially different financial system. One of the main characteristics of this new system is interdependence.<sup>24</sup> Portfolio investment flows have steadily grown and diversified as a result of financial interdependence. This has increased financial instability, as proved by recurrent banking and currency crises from the 1980s onwards.<sup>25</sup> Given the depth and width of inter-state financial links, crises in one country or region now affect other countries as well. Thus, a different GFSN from the one established post-1944 was needed. Policy-makers quickly grasped this – especially following foreign exchange-related problems afflicting banks in Germany and the US – and the current GFSN regime started to be developed in the early 1980s.

Throughout this period, the regime continued to be composed by one layer only. The GFSN was discussed and agreed upon at the global level. Nevertheless, there were

two key differences with the pre-1980s period. Firstly, the BIS became the dominant institution in the regime. More specifically, the BCBS took the leading role in developing a GFSN regime. Secondly, the regime started to be codified through implementation of the Basel I Accord on Capital Adequacy (Basel I).

Based at the BIS, the BCBS was set up in 1974 by the central bank governors of the G10 countries.<sup>26</sup> Entrusted to develop common supervisory standards and to recommend best practice,<sup>27</sup> by the 1980s it had become the central institution in the GFSN. Bringing together central monetary authority governors and other government bureaucrats with first-hand expertise of financial markets, the BCBS was relatively free from inter-state politics compared to other international institutions. Notwithstanding the relatively limited role of politics in shaping the work of the BCBS, the US and the UK did seek to enhance the competitiveness of their banking sectors while imposing costs on Japanese and German banks.<sup>28</sup>

The BCBS thus agreed on Basel I, released in 1988. This accord was a response to the effects on international banks of the Latin American debt crises of the 1980s. There was a realisation that international banks were poorly prepared to operate in an increasingly volatile international environment.<sup>29</sup> American banks were the most affected by the crisis, leading the US government to press for the creation of this accord.<sup>30</sup> Basel I established a new goal: crisis prevention. The accord introduced minimum capital requirements for international banks operating across borders. These minimum capital requirements would allow banks to withstand possible losses related to their international operations.<sup>31</sup> This way, a crisis in one country would not spread to that country's own international banks or to other countries through their respective international banks.

The crisis prevention goal led to the behavioural expectation of development of standards and codes. These were the remit of the BCBS.<sup>32</sup> First codified in Basel I, they were under frequent discussion and review in order to better reflect the evolution of the global financial system. Therefore, amendments were introduced during the 1990s to reflect the risks associated with the creation or increase in popularity of different financial products – such as derivatives – or to update banks' internal risk models, for example.<sup>33</sup> Even though the G7/8 was an important political force behind

the move to develop standards and codes, these were discussed and agreed by the BCBS.<sup>34</sup> Crisis management remained as a second goal of the GFSN, still under the auspices of the IMF. Basel I was designed both to prevent the spread of a financial crisis to a country's own international banks and to avoid the spread of the crisis to other countries. Nevertheless, there is evidence that crises recur in increasingly open financial systems.<sup>35</sup> Thus, the behavioural expectation of distressed sovereigns accepting bailout packages from the IMF to overcome short-term liquidity difficulties remained unchanged. Due to the belief that developing and emerging countries with less sophisticated financial markets suffer from a so-called 'emerging market risk',<sup>36</sup> they would still need help in managing crises as they opened up.

### *The development of a multi-layered GFSN regime*

Throughout the 1990s, financial crises affected countries and regions as diverse as East Asia, Finland, Latin America, Russia or Sweden. Some of these crises were the result of external factors – such as a rapid withdrawal of portfolio investment – while others were linked to domestic factors – for example, the sudden collapse of a housing bubble. Many of these crises spread beyond the country or region of origin, affecting international banks exposed to the financial sectors of other countries. The fact that states and regions at different stages of development and geographically far away suffered from financial crises, together with controversies regarding the role that the IMF played in several of them, led to substantial changes in the GFSN regime.

To begin with, and most notably, the GFSN regime became multilayered, incorporating new institutions and countries. Throughout the 1990s and early 2000s, a global layer still centred around the BCBS and, to an extent, the IMF grew with the launch of the Financial Stability Forum (FSF) in 1999. Meanwhile, regional institutions were created in ASEAN+3 or the Eurozone. Concurrently, a domestic layer based upon central bank reserve accumulation also appeared.

The goals of the regime also increased. Financial market strengthening was introduced as a third objective to be achieved as part of the GFSN. This was done at the regional level. An example was East Asia, where the Asian Bond Market Initiative (ABMI) was launched to create a strong local currency denominated bond market.<sup>37</sup>

Meanwhile, EU-level financial market regulation harmonization discussions became more common in the late 1990s and early 2000s. The Financial Services Action Plan endorsed by the European Council in 2000 was a turning point in this respect.<sup>38</sup> The objective was to create a stronger financial sector across the region through the creation of an integrated market.

Notwithstanding the above, crisis prevention and crisis management remained as the two key objectives of the GFSN regime. With regards to the former, an expanded BCBS introduced Basel II in 2004. This accord implemented higher capital adequacy requirements for international banks.<sup>39</sup> The behavioural expectation that standards and codes reflecting developments in the international financial system would be introduced was therefore kept. Differently from the previous accord, Basel II was not the result of US pressure mainly, but instead was negotiated as a result of disagreements between Washington and several European governments – most notably, Berlin.<sup>40</sup>

During the 1990s and up to the Global Financial Crisis (GFC), a second behavioural expectation related to crisis prevention was introduced. This was monitoring of implementation and information sharing. National authorities together with the IMF, the World Bank and bilateral financial safety nets (BFSN) were the initial drivers behind this expectation. Thus, the IMF and the World Bank jointly prepared Financial Sector Assessment Programmes and Reports on the Observance of Standards and Codes.<sup>41</sup> These new instruments suggest that national authorities became more actively involved in the GFSN regime, both through government-led institutions and through the implementation of agreed initiatives.

A third behavioural expectation related to crisis prevention also introduced during this period was oversight and coordination. The FSF was responsible for fulfilling this expectation. It included finance ministries' officials, central bank governors, and international financial institutions' staff.<sup>42</sup> This further compounded the bureaucratised nature of the GFSN regime, since oversight and coordination were centralised in an institution host to experts with technical knowledge about financial markets. In common with the BCSB, the FSF was also managed by the BIS, which thus became an umbrella organisation for the GFSN regime.

Crisis management, meanwhile, ceased to be the remit of the IMF only. In ASEAN+3, the Chiang Mai Initiative (CMI) was launched in 2000. Intended to supplement IMF funds, the CMI stemmed from the realisation that financial crisis could become regional, as had been the case with the EAFC.<sup>43</sup> Concurrently, self-insurance in the form of central bank reserve accumulation and bilateral swap agreements also became common, including in East Asia.<sup>44</sup> Capital accumulation and swap agreements were also the result of a trend towards reducing possible dependence on IMF bailout packages in periods of distress.

### *Increasing complexity of the GFSN regime post-Global Financial Crisis*

The GFC showed the shortcomings of an arguably dysfunctional GFSN regime. Prevention mechanisms did not avert the crisis. Crisis management institutions could not swiftly put an end to it. Meanwhile, the strength of developed country financial markets was put into question, since the crisis originated and lasted longer in the US and the EU. After proving inadequate, politicians, policy-makers, experts, and even the private sector launched a process to create a more robust GFSN regime that, building on existing goals and institutions, would serve to avoid a repetition of the 2007-08 crisis.

Spurred by the GFC, the GFSN regime became truly multilayered. The BIS increased its membership,<sup>45</sup> becoming less Western-centric through the incorporation of more monetary authorities from emerging and developing countries. The FSF was upgraded and rebranded as the FSB in 2009,<sup>46</sup> further enhancing the role of states outside of North America and the EU. Meanwhile, the role of BFSNs, the IMF and the World Bank in the GFSN regime was boosted.<sup>47</sup>

Concurrently, the regional and domestic layers grew in relevance. In ASEAN+3, the CMI was multilateralised and saw its financial resources increased in 2009. It was rebranded as the Chiang Mai Initiative Multilateralisation (CMIM).<sup>48</sup> A new monitoring institution, the ASEAN+3 Macroeconomic Research Office (AMRO), was launched in 2011.<sup>49</sup> In the Eurozone, two temporary financial assistance mechanisms created to deal with the Eurozone Debt Crisis – the European Financial Stability

Facility and the European Financial Stabilisation Mechanism – eventually morphed into a permanent institution in 2012 – the European Stability Mechanism (ESB).<sup>50</sup> Meanwhile, countries across the world strengthened self-insurance mechanisms – bilateral swap agreements and reserve accumulation – that proved useful to limit the impact of the GFC.

The importance of crisis prevention as the main goal of the GFSN regime increased due to the devastating effects of the GFC. Basel II had not been fully implemented when the crisis struck. It would be replaced by Basel III in 2013. The new accord set even higher capital adequacy requirements for international banks, while also introducing leverage and liquidity ratios to further strengthen their balance sheets.<sup>51</sup> Basel III was negotiated much more rapidly than the two preceding accords,<sup>52</sup> underscoring the reduced impact of inter-state politics in the further development of the GFSN.

In addition, discussions about tightening regulation and potentially introducing higher capital adequacy requirements for “global systematically important financial institutions” were also launched.<sup>53</sup> These financial institutions were insurance companies. For the first time, large institutions involved in financial markets other than international banks were due to become regulated in order to prevent future crises. This enhanced the role of the International Association of Insurance Supervisors, which plays a similar role in the area of insurance to the BCBS’ in banking.

The FSF/FSB became more active. The Board worked closely with the BCBS on Basel III.<sup>54</sup> The FSB also set the conditions for discussions about the regulation of insurance companies.<sup>55</sup> State monetary authorities, financial market regulations, and ministries of finance, together with international institutions such as the BCBS, the BIS, the IMF, and the World Bank are all part of the FSB.<sup>56</sup> This means that the behavioural expectation of development of standards and codes started to be led by national authorities together with international institutions, thus bridging previous gaps between these two layers. This development further enhanced the bureaucratised nature of the GFSN regime.

With regards to the monitoring of implementation and information sharing and oversight and coordination, these two expectations were still conducted by the FSF/FSB, the IMF and the World Bank. However, national authorities became more active in these areas as well.<sup>57</sup> In many countries, they had been accused of failing to regulate the financial sector properly. There had also been accusations that financial firms had little incentive to self-regulate effectively. After the GFC, this was another area in which the domestic and the global layers grew closer.

Similar changes occurred with regards to the goals of crisis management and financial market strengthening. New institutions became involved in both of them. The IMF remained as the main liquidity provision institution at the global level, but the CMIM and the ESB were launched with a view to reduce future dependence on its bailout packages in ASEAN+3 and the Eurozone, respectively.

As for financial market strengthening, regional institutions and national authorities became more active. At the regional level, the Asian Development Bank and ASEAN+3 launched the Credit Guarantee and Investment Facility (CGIF) in 2011. The goal was to develop a large private sector bond market. At the domestic level, financial authorities in the US sought to apply tighter standards than those set by Basel III.<sup>58</sup> In the EU, discussions about a pan-European financial transaction tax were launched.<sup>59</sup> These are three examples among several demonstrating the extent to which the regional and domestic layers became more important.

**Table 1. Evolution of the GFSN regime**

Period	Layers	Main global institutions	Goals	Behavioural expectations
1944-1971	Global	IMF	Crisis management	Liquidity provision acceptance by stressed sovereign
1971-late 1990s	Global	BCBS & IMF	Crisis prevention & crisis management	Same as above & development of standards and codes
Late 1990s-2008	Global, regional & domestic	BCBS & IMF	Crisis prevention, crisis management & financial market	Same as above, monitoring of implementation and

			strengthening	information sharing & oversight and coordination
2008-present	Global, regional & domestic	BCBS, FSB & IMF	Crisis prevention, crisis management & financial market strengthening	Same as above

In the next section, we will analyse in detail the ASEAN+3 regional layer. Focusing on the question set out above, we will examine the factors that have underpinned the establishment of a better defined RFSN in the region, and how these factors underpin complementarity between the RFSN net and the broader GFSN regime.

#### **4. ASEAN+3 as a Regional Layer of the Global Financial Safety Net**

Throughout the previous section we already teased out key reasons shaping the development of an ASEAN+3 RFSN. In this section we will expand on these reasons – while touching upon the politics behind the development of this particular RFSN – and analyse the safety net created after the EAFC in detail. Before the EAFC, the only RFSN in Southeast Asia was the ASEAN Swap Arrangement (ASA), which was established in August 1977 when the original members of ASEAN – Indonesia, Malaysia, Philippines, Singapore, and Thailand – agreed to a reciprocal currency swap arrangement among themselves. The idea was to provide liquidity support to members experiencing balance of payments difficulties. The maximum amount of liquidity available under the ASA was \$100 million, with each member providing \$20 million. Subsequently, the maximum amount was doubled to \$200 million. The size of the ASA was too small to be useful in helping countries manage the EAFC and so it was not used.

##### *Crisis prevention and management*

The EAFC led countries to revisit the issue of a RFSN mainly because of the way in which the IMF managed the crisis. Four of the crisis-affected countries – Indonesia, South Korea, the Philippines and Thailand – had accepted an IMF programme. The IMF misdiagnosed the problem and prescribed the wrong medicine – a fact that it



acknowledged later.<sup>60</sup> It was also believed at the time that the IMF might not have adequate resources to help countries manage a ‘capital account’ crisis associated with large inflows and sudden reversals of private capital flows.<sup>61</sup> Politically, it became necessary for the governments of the countries affected by the EAFC to develop mechanisms to avoid future appeal to IMF rescue packages.

There were calls for establishing an Asian Monetary Fund, which did not materialise because of insufficient political support within the region and opposition from the US.<sup>62</sup> Notwithstanding, there was a strong feeling among policymakers that a regional financing facility could act as the first line of defence by providing short-term liquidity and thereby prevent a crisis when speculative attacks occurred.<sup>63</sup> Therefore, at their May 2000 meeting in Chiang Mai, the ASEAN+3 finance ministers agreed to launch the CMI as a regional “self- help and support mechanism” to provide “sufficient and timely financial support to ensure financial stability in the East Asia region” and to “supplement the existing international facilities.”<sup>64</sup> The CMI expanded the ASA to all ASEAN members and set up a network of bilateral swaps among the ASEAN+3 countries. The ASA was subsequently expanded to \$1 billion in November 2000 and then to \$2 billion in May 2005. ASEAN+3 countries also signed bilateral swaps among each other and by 2008 there were 16 bilateral swaps amounting to \$84 billion.

Yet once again the RSFN in East Asia comprising the ASA and CMI bilateral swaps was not used when the region faced a severe credit crunch in 2008 because of the sub-prime mortgage crisis in the US and subsequent GFC. Countries in the region (e.g., Singapore and South Korea) instead resorted to their bilateral swaps with the US Federal Reserve, which at that time acted as the international lender of last resort.<sup>65</sup> This was mainly because of the lack of conditionality to trigger the CMI swaps and their small sizes. Thus, East Asian countries resorted to the swap lines with the US, as countries in other regions did as well. Indeed, a total of 14 central banks worldwide would borrow nearly US\$ 600 billion at the peak of the crisis, in December 2008.<sup>66</sup>

In the post-GFC period, the case for a RFSN in East Asia has strengthened further for two reasons. Firstly, in an environment where economic growth in the industrial countries has been sub-par compared to that in emerging markets, especially those in

Asia, East Asian countries have sought to re-balance growth by finding markets within the region. Also, the slow progress in reforming the governance of the IMF has enhanced the case for a RFSN in East Asia to complement the IMF.<sup>67</sup> This slowness has made East Asian countries feel that they are in a subordinate position within the GFSN. ASEAN+3 has, therefore, taken a number of actions to strengthen the RFSN in the region. These actions have created a well-developed regional layer in East Asia.

Firstly, the CMI has been multilateralised into the CMIM. In March 2010, the bilateral swaps were combined and expanded to become the CMIM or the \$120 billion 'self-managed reserve pool' governed by a single contract.<sup>68</sup> Two years later the size of the pool was doubled to \$240 billion.<sup>69</sup> As a self-managed reserve pool, the contributions remain in the central banks of the member countries and are not actually paid into a centralised reserve pool. This underscores that a degree of mistrust in the region still prevents the creation of a centralised pool.

Secondly, contributions, borrowing rights, and operational guidelines of the CMIM have been fixed. All ASEAN+3 member countries – plus Hong Kong – have contributed to the CMIM and are eligible to borrow from it using a multiplier – so that the smaller countries can borrow more – in case they face a payments problem. To access the CMIM, a member country must submit a request to the Coordinating Countries – the co-chairs of the ASEAN+3 – which then deliver the request to a non-resident Executive Level Decision Making Body. This body then has to convene and take a decision based on a 2/3 majority within two weeks from the receipt of the swap request.<sup>70</sup>

Assessing the effectiveness of the CMI/CMIM as part of the RFSN is complicated, since it is yet to be used.<sup>71</sup> It could even be argued that it serves strategic rather than functional objectives.<sup>72</sup> Nevertheless, the rapid development of the CMIM even though ASEAN+3 countries have suffered relatively little from the GFC suggests intent in making it a valid option. The CMI saw little evolution following its launch. In contrast, the CMIM pool is growing in size, the unlinked portion from the IMF is increasing (see below), and an institutional framework to support it is being built, as explained in the third and fourth points immediately below.

Thirdly, AMRO has been established and its capacity is being enhanced. With the multilateralisation of the CMI, there was a need for an independent surveillance unit to conduct due diligence so that the borrowing countries' capacity to repay the loan could be assessed. In May 2011, AMRO was established as a limited company in Singapore. AMRO's activities are divided into functions during so-called peace time and crisis time. During peace or non-crisis periods, AMRO's main responsibility is to prepare quarterly consolidated reports on the overall macroeconomic assessment of the ASEAN+3 region as well as on individual ASEAN+3 countries.<sup>73</sup> Should a crisis occur, however, its role and responsibilities multiply. During crisis time, AMRO is tasked to (i) provide an analysis of the economic and financial situation of the CMIM Swap Requesting Country, (ii) monitor the use and impact of the funds disbursed under the CMIM agreement, and (iii) monitor the compliance by the CMIM Swap Requesting Country with any lending covenants to the CMIM agreement.<sup>74</sup>

Finally, several other key decisions were taken in the May 2012 meeting of the ASEAN+3 finance ministers. The ASEAN+3 Finance Ministers Meeting was upgraded to the ASEAN+3 Finance Ministers and Central Bank Governors Meeting. For the first time, the central bank governors of the 13 countries plus the head of the Monetary Authority of Hong Kong were invited to participate in the forum. This was a significant move as it brings together officials handling tax and expenditure policies with those handling monetary and exchange rate policies. Furthermore, a crisis preventive facility, the CMIM Precautionary Line, was introduced; it is similar to various contingent credit lines at the IMF.<sup>75</sup>

### *Financial market strengthening*

Prior to the EAFC, borrowing in the region was largely short-term and in US\$, the currency to which most currencies in East Asia were pegged. Short-term US\$ borrowing was used for long-term investments in local currencies. Therefore, there was a maturity and currency 'double mismatch'.<sup>76</sup> The EAFC laid bare the inadequacy of this arrangement. The erosion in trust towards some currencies in the region and rapid capital outflows swiftly spread the crisis throughout East Asia.<sup>77</sup> From a political perspective, it became necessary for governments in the region to

create stronger financial markets, thus avoiding dependence on the US\$ and preventing future crises requiring IMF-led intervention.

To strengthen financial markets in the region, the August 2003 ASEAN+3 Finance Ministers Meeting agreed measures to develop local currency denominated bond markets – the aforementioned ABMI.<sup>78</sup> Under this initiative, regional and government institutions increased the supply of local currency denominated bonds, contributing to the diversification and expansion of regional bond markets.<sup>79</sup> The local currency denominated bond market grew in size from US\$131 million in 1997 and US\$1,099 million in 2002 to US\$6,365 million in 2012.<sup>80</sup>

In the aftermath of the GFC, a second financial market strengthening mechanism was introduced. Agreed in May 2008 and launched in November 2010, the CGIF was created to boost long-term investment in ASEAN+3 by providing guarantees on corporate local currency denominated bonds. The CGIF seeks to reduce the double mismatch just explained.<sup>81</sup> This would make financial markets in the region more resilient to sudden reversals of private capital flows and external shocks. The main beneficiaries would be corporations experiencing difficulties in tapping bond markets. As of 2013, ASEAN+3 countries and the Asian Development Bank had contributed US\$700 million towards the CGIF.<sup>82</sup>

**Table 2. Evolution of the ASEAN+3 RFSN regime**

Period	Scope	Main institutions	Goals	Behavioural expectations
Pre-EAFC	Sub-regional	ASA	Crisis prevention & crisis management	Liquidity provision acceptance by stressed sovereign
Post-EAFC-2008	Regional	ABMI & CMI (incl. ASA)	Crisis prevention, crisis management & financial market strengthening	Same as above
2008-present	Regional	ABMI, AMRO, CGIF & CMIM	Crisis prevention, crisis management & financial market strengthening	Same as above, monitoring of implementation and information sharing

				& oversight and coordination
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As a comparison of tables 1 and 2 shows, the evolution of the ASEAN+3 RFSN and GFSN goals has run in parallel. Meanwhile, the scope of behavioural expectations of East Asia's RFSN is narrower. Development of standard and codes is not part of the ASEAN+3 remit, at least yet, and monitoring and implementation and oversight and coordination only became part of the region's financial safety net post-GFC; that is a decade after they were included in the global layer. This suggests that the ASEAN+3 RFSN complements rather than undermines the GFSN.

#### *Complementarity between the ASEAN+3 layer and the GFSN*

During the past several years, a number of significant steps have been taken to strengthen CMIM/AMRO or the RFSN in Asia. But the question is: are these steps to strengthen the RFSN adequate to make them a viable option that countries could consider and use independently from the GFSN the next time that they face a liquidity crisis? The answer is, probably not. This is mainly because it will take a long time for AMRO to build a capacity to develop and design conditionality that is independent of the IMF and for other ASEAN+3 initiatives to become fully autonomous too, due to the political mistrust already mentioned. The RFSN must, therefore, complement the GFSN rather than try to supplement it.

In fact, as highlighted above, the May 2000 Joint Statement of the ASEAN+3 Ministers had stipulated that the RFSN in East Asia should "supplement the existing international facilities." The way this complementarity is carried out in the CMI/CMIM is by requiring the existence of an IMF-supported programme to provide assistance in excess of a certain percentage of maximum access. Initially, only ten per cent of the maximum access was readily available, with 90 percent linked to an IMF program. Gradually the size of the unlinked portion has been increased. Presently, it is 30 per cent and is expected to be 40 per cent soon.<sup>83</sup>

The link to the IMF was also intended to address the moral hazard problem and the lack of independent surveillance capacity in the CMI/CMIM. By comparing the

situation with RFSNs in other parts of the world, Henning has concluded that “... the CMI is more sensitive to preserving the central position of the IMF and not undercutting the IMF in negotiations with borrowing countries than these other arrangements.”<sup>84</sup>

Certainly, increasing the unlinked portion of the CMIM maximum access to 40 per cent suggests that the link with the IMF is becoming more tenuous. However, and in spite of the poor image that the IMF enjoys in East Asia, mistrust among countries in the region helps to explain why, from a political viewpoint, it is still unfeasible to develop a truly independent RFSN. Most notably, Sino-Japanese rivalry enhances the possibility of the IMF link remaining.<sup>85</sup> Furthermore, the IMF has been willing to take a cooperative stance in areas such as capacity building and information sharing with AMRO, which is still developing its capabilities. Most notably, the first AMRO-IMF joint seminar was held in January 2014.<sup>86</sup> This suggests that the IMF has decided to engage with the ASEAN+3 RFSN rather than to treat it as a competitor. This is a wise decision from a political perspective, given that East Asian countries are still underrepresented in the IMF in terms of voting share.

Furthermore, the decisions taken at the March 2010 and May 2012 meetings of the ASEAN+3 finance ministers have made the CMIM a stronger regional financial safety net. However, although the CMIM’s size has increased significantly to \$240 billion, it is unlikely to be sufficient, on a standalone basis, if there were to be a full blown systemic crisis in the region. During the EAFC, Thailand received over \$17 billion in emergency liquidity. Yet, Thailand – and other original ASEAN members – can access only a fraction of the amount, about \$7 billion from the CMIM without an IMF programme. Indonesia received almost six times (\$40 billion) of what its unlinked portion of the CMIM can provide.<sup>87</sup>

For the CMIM to be an effective RFSN, either the size of the crisis fund or the percentage of unlinked portion needs to be increased substantially.<sup>88</sup> These can happen only gradually and over a period of time. Hence, an alternative way to promote complementarity between CMIM and IMF through a more structured approach of CMIM/AMRO/IMF cooperation such as in the ‘troika’ model being used by the EU is under consideration.<sup>89</sup> In the EU, bailout packages are jointly designed,

financed, and monitored by the European Central Bank, the European Commission, and the IMF.<sup>90</sup> Such joint activities could go a long way in further promoting complementarity between the RFSN in East Asia and the IMF. Presently, collaboration between AMRO and the IMF is for the most part informal, with the IMF providing technical inputs to AMRO's surveillance activities.

Similarly, there are links between the RFSN and the BIS/BCBS. The EAFC crisis highlighted the problems of inadequate bank governance and regulation in East Asia. This led to an overhaul of banks and to recognition of the need for developing local currency bond markets. Thus, two initiatives that are on-going at the regional level are (i) the creation of the pan-Asian Asian Bond Funds (ABF) under the auspices of EMEAP, and (ii) the ABMI of the ASEAN+3. The former focuses on boosting the demand for local currency bonds, while the latter seeks to enhance the supply of such bonds. While the ABMI is managed by ASEAN+3, the ABF is managed by the BIS. This entrenches the relationship between the BIS and the RFSN, even if through a pan-Asian institution. The relationship between the BIS/BCBS has been further strengthened by the fact that more East Asian central banks joined the BIS<sup>91</sup> and the BCBS<sup>92</sup> following the GFC.

In addition, and similarly to the case of the IMF, the BIS does not seem to treat ASEAN+3 as a competitor. Indeed, ASEAN+3 countries have encouraged AMRO to engage with the BIS in order to bolster its institutional capacity.<sup>93</sup> As already observed, several East Asian countries have gained membership of the BIS – and the BCBS – following the GFC. Thus, it could be argued that the subordinate role of East Asian countries within these institutions is less clear, at least from a political point of view. This would make ASEAN+3 countries more willing to engage with the BIS/BCBS.

Also, the BCBS engaged with ASEAN+3 countries when developing Basel III. The 2004 Basel II was the result of an agreement between the US and the EU.<sup>94</sup> This underscored the subordinate role of non-Western countries in the GFSN. Differently, negotiations leading to Basel III involved East Asian countries,<sup>95</sup> among others. As a result, countries in the region would feel more comfortable with the RFSN that they

have developed complementing rather than replacing a GFSN to which they have contributed.

Differently, links between the RFSN and the FSB are non-existent. However, this is the result of an institutional vacuum in East Asia rather than disagreement between the FSB and a regional equivalent. At present, at the ASEAN+3 level, there is no forum where bank regulators are involved. Calls have, however, been made to establish an Asian Financial Stability Dialogue (AFSD) to promote regional financial stability which would involve finance ministers, central bank governors, and bank regulators and supervisors. The objectives of the AFSD would be to (i) monitor factors affecting regional financial stability, including national financial market conditions and capital flows, and (ii) design appropriate policy actions.<sup>96</sup> The idea is that this institution would operate like a regional FSB in Asia. When established, it could be linked to the FSB. This would further reinforce the complementary role of the ASEAN+3 RFSN.

## **5. Conclusion**

The proliferation of RFSNs does not spell the end of the GFSN. As this article has shown, RFSNs can complement the GFSN. The case of the ASEAN+3 regional net clearly illustrates this point. Considering that the IMF's handling of the EAFC was heavily criticised in East Asia, the fact that countries in this region henceforth developed a complementary rather than competing safety net is a positive sign for the GFSN. Indeed, the Eurozone's response to its own sovereign debt crisis suggests that RFSNs elsewhere are also complementary to the global net.

As Haggard and Simmons explain, regimes evolve when they become dysfunctional.<sup>97</sup> The evolution of the GFSN regime is a case in point. From the late 1990s onwards, the global layer was supplemented by regional and domestic layers and new goals and behavioural expectations appeared. This is the context in which East Asia's and other RFSNs first originated. In the same way that the trade or environmental regimes have evolved and adapted to their changing circumstances,<sup>98</sup> the financial safety regime has shown flexibility to accommodate new layers. Evolution and adaptation underpin the complementarity between the RFSN and the



GFSN and help to allow the latter overcome the dysfunctionality it has been accused of due to the GFC.

Meanwhile, the ASEAN+3 RFSN is modelled on the GFSN. The issue around which it has been created (i.e., financial stability) and its goals and behavioural expectations – as laid out in table 2 – are indistinguishable from those of the global net. As explained in section 2, these are the three essential characteristics of all international regimes. Sharing the characteristics of the GFSN further compounds the complementary nature of the ASEAN+3 RFSN. It is likely that other RFSNs also share these characteristics.

Our research is not without shortcomings. Most notably, it would be interesting to study other RFSNs and their relationship with the GFSN. It would also be worth analysing in depth the role of domestic safety nets in a multilayered global financial governance regime. Nevertheless, this article shows how different crises and the limitations of previous versions of the GFSN have led to the evolution of this safety net. Most notably, RFSNs are being created to complement a decades-old GFSN and together strengthen multilateral financial governance.

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<sup>1</sup> We would like to thank two anonymous reviewers for their comments. All errors remain ours.

<sup>2</sup> The IMF defines the global financial safety net as “a set of crisis prevention and resolution instruments, encompassing self-insurance (reserves); bilateral arrangements (e.g., swap lines between central banks during periods of stress); regional arrangements such as those in Asia, Europe and Latin America; and multilateral arrangements with the IMF at their centre.” We understand this definition in a broad sense, treating the GFSN and other safety nets as regimes not only circumscribed to liquidity provision but also involving other crisis prevention and resolution instruments. See IMF, *Global Financial Safety Nets* (November 7, 2011), available at <<http://www.imsreform.org/safety.html>> (accessed on November 12, 2013).

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